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REVIEW OF STATE TIDELANDS LEASES
EXECUTED BY THE STATE LANDS COMMISSION
WITH OIL COMPANIES AND
PUBLIC UTILITIES

JANUARY 1974

Joint Legislative Audit Committee

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January 31, 1974

The Honorable President of the Senate
The Honorable Speaker of the Assembly
The Honorable Members of the Senate and the
Assembly of the Legislature of California

Dear Members:

Transmitted herewith is the Auditor General's report on the State Lands Commission and its staff agency, the State Lands Division. The report concerns tidelands leases with oil and utility companies for marine terminal facilities. As of December 31, 1973, there were 27 such tidelands leases for transferring petroleum and related products between ship and shore.

The state receives current annual revenues from 24 of these leases for 1,316 acres totaling \$198,546. The annual revenues per acre from these leases range from \$5.88 to \$900.32. Three other 49-year leases provide one-time payments to the state totaling \$9,240.

The Auditor General's review of these leases disclosed that the determinations of appraised values for the leased tidelands, which serve as the basis for revenues from the oil companies and public utility company leases, are largely arbitrary and have resulted in low and inequitable revenues to the state. For example, four leases with Standard Oil Company of California for tidelands property at Richmond and El Segundo produced annual revenues per acre to the state ranging from \$140.82 to \$299.69. These leases cover 538 acres of state-owned tidelands adjacent to the company's two largest California refineries which have combined annual capacities of approximately 150 million barrels of oil.

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While recognizing that the State Lands Commission has been making increases in recent lease renewal rates, they are still low. For example, the Commission approved a lease extension in June 1973 with Standard Oil Company of California which increases the annual revenues from \$5,694 to \$34,218 annually. However, the annual revenue per acre is only \$141.

As an example of what another jurisdiction derives from a terminal lease, the Port of Long Beach currently has a marine terminal lease with Atlantic Richfield Company for approximately 21 acres. Under the terms of that lease, the Port of Long Beach derives \$157,682 annually. This amounts to annual revenues per acre of over \$7,500 or over \$7,359 per acre more than the Commission's lease with Standard. A second example is a lease of 18 acres by the Port of San Francisco to Bethlehem Steel Company for unimproved submerged tidelands for an annual revenue per acre of \$2,300.

The Auditor General points out that the value of tidelands to a commercial user is relative to the amount of income estimated from its use. Lease rates based on the number of barrels of petroleum and related products transferred between ship and shore is a far more equitable basis for lease rates than arbitrary determinations of appraised values. Currently, the Port of Long Beach and the Port of Los Angeles charge 3/4 and 1/2 cents respectively, per barrel for all petroleum and related products loaded or unloaded through private pipelines in their ports.

The Auditor General has recommended that the State Lands Commission charge a minimum rate of one cent per barrel for petroleum and related products transferred between ship and shore for renewals and future leases of state-owned tidelands for marine terminal facilities.

Implementation of this recommendation will double annual revenues to the state within the first two years and will total a minimum of \$2.4 million annually once all of the leases have been renewed.

As an alternative to the preceding recommendation, it is recommended that the Legislature consider the imposition of a tax, subject to applicable constitutional requirements, of at least one cent per barrel on oil. This tax offers the potential of an immediate increase in state revenue of \$2.4 to \$3.5 million annually.

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The Auditor General points out that the Commission does not charge interest on retroactive lease payments. Negotiations between the Commission and oil companies often take years to complete. During 1972-73, the Commission approved lease payments for five leases with Standard Oil Company of California. Standard paid \$429,319.64 in retroactive payments for these five leases. However, the Commission did not include any interest in the retroactive payments made by Standard.

The Auditor General recommends that the State Lands Commission include interest at not less than the prime rate on retroactive lease payments. In the event of the failure of the Commission to adopt this policy, we recommend that the Legislature consider adoption of legislation to require such interest.

Timely implementation of this recommendation will produce additional interest income to the state of approximately \$110,000 for two leases with Phillips Petroleum Company scheduled to be presented to the Commission for its approval at its February 6, 1974 meeting. Additional savings could result from charging interest on subsequent retroactive payments.

Respectfully submitted,

A handwritten signature in cursive script, appearing to read "Vincent Thomas".

VINCENT THOMAS, Chairman
Joint Legislative Audit Committee

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INTRODUCTION

In response to a legislative request, we reviewed the operations of the State Lands Commission and its staff agency, the State Lands Division concerning tidelands leases for marine terminal facilities.

The State Lands Commission has executed leases of state-owned tidelands to oil and utility companies who use the facilities for transferring petroleum and related products between ship and shore.

FINDINGS

DETERMINATIONS OF APPRAISED VALUES
FOR MARINE TERMINAL FACILITIES, WHICH
SERVE AS THE BASIS FOR REVENUES
RECEIVED FROM OIL COMPANIES AND PUBLIC
UTILITY COMPANIES LEASES, ARE LARGELY
ARBITRARY AND HAVE RESULTED IN
LOW AND INEQUITABLE REVENUES TO THE STATE

As of December 31, 1973, there were 27 tidelands leases between the State Lands Commission and various oil companies and public utilities for transferring petroleum and related products between ship and shore. The current annual revenues from 24 of these leases covering 1,316 acres total \$198,545.72. The annual revenues per acre from these leases range from \$5.88 to \$900.32. Three other 49-year leases provided one-time payments to the state totaling \$9,239.89. These three leases are as follows:

<u>Company</u>	<u>Year Expires</u>	<u>Amount</u>
Pacific Gas and Electric Company	5/2003	\$ 375.00
Gulf Oil Company	5/2001	1,002.25
Southern California Edison Company	6/2007	<u>7,842.64</u>
Total		<u>\$9,239.89</u>

In our judgment, the following schedule of the 24 tidelands leases shows the low annual revenues that the state presently receives from oil companies and public utility companies.

Revenues from 24 Tidelands Leases
Paid to the State for Transferring
Petroleum and Related Products Between
Ship and Shore
As of December 31, 1973

<u>Company and Location</u>	<u>Year Expires</u>	<u>Number Of Acres Leased</u>	<u>Annual Revenues</u>	<u>Annual Revenues Per Acre</u>
Standard Oil Company of California				
Richmond	1977	243	\$ 34,218.65	\$140.82
Port Orient	1982	21	5,906.80	281.28
Estero Bay	1974	220	2,904.00	13.20
El Segundo	1982	97	29,069.78	299.69
El Segundo	1977	81	18,268.84	225.54
El Segundo	1985	117	27,026.48	231.00
Phillips Petroleum Company				
Martinez	1961	16	999.64	62.48
Martinez	1964	11	385.00	35.00
Port Costa	1977	1	198.60	198.60
Pittsburg	1975	3	2,700.96	900.32
Union Oil Company of California				
San Pablo Bay	1976	16	13,680.00	855.00
Cojo Bay	1983	5	859.92	171.98
Ventura	1966	19	129.04	6.79
Shell Oil Company				
Martinez	1963	19	1,120.52	58.97
Capitan	1974	4	183.41	45.85
Getty Oil Company				
Gaviota	1974	2	159.34	79.67
Gaviota	1965	17	100.00	5.88
Pacific Gas and Electric Company				
Pittsburg	1980	120	24,240.00	202.00
Signal Companies Inc.				
Carquinez Strait	1975	10	3,471.13	347.11
Elwood	1983	3	278.30	92.77
Urich Oil Company				
Martinez	1998	31	6,551.12	211.33
Sequoia Refining Corporation				
San Pablo Bay	1980	20	10,000.00	500.00
Texaco Inc.				
Estero Bay	1976	167	2,432.19	14.56
San Diego Gas and Electric Company				
San Diego	2002	<u>73</u>	<u>13,662.00</u>	187.15
Totals		<u>1,316</u>	<u>\$198,545.72</u>	

Note: The above revenues include charges for pipeline right-of-way. Since 1969 such charges have been calculated at one cent per diameter inch per lineal foot of pipeline length.

The above acreages are in some cases understated due to the exclusion of some offshore mooring areas from the lease agreement.

Expiration dates prior to 1974 represent expired leases for which new terms are being negotiated between the Commission staff and the lessees.

Four leases with Standard Oil Company of California at Richmond and El Segundo produce annual revenues per acre to the state ranging between \$140.82 and \$299.69. These leases cover 538 acres of state-owned tidelands adjacent to Standard Oil Company's two largest California refineries which have combined annual capacities of approximately 150 million barrels of oil.

The 27 leases were approved by the Commission from 1947 through 1973; eight of these were approved during the last two years. These leases are due to expire over the next 34 years.

We recognize the fact that the State Lands Commission in setting revenue rates for recent lease renewals has been making increases over the rates previously charged because as the Executive Officer of the Commission stated the leases should reflect rising market values. However, in our judgment, the current rates and resulting revenues are still low and are not in the best interests of the state. For example, in the lease with the Standard Oil Company of California at Richmond, the Commission approved a lease extension in June 1973 to locate and operate a wharf over 243 acres of tidelands. While the revenues under this lease increased from \$5,694 annually to \$34,218 annually, it still results in an annual revenue per acre of only \$141.

As examples of what other jurisdictions derive from a terminal type lease, the Port of Long Beach currently has a lease with Atlantic Richfield Company for approximately 21 acres of partially submerged tidelands. Under the terms of this lease, the Port of Long Beach derives \$157,682.17 annually,

which represents annual revenues per acre of over \$7,500 or over \$7,359 per acre more than the Commission's lease with Standard. The Port of San Francisco currently leases approximately 18 acres of unimproved submerged tidelands to the Bethlehem Steel Company. This amounts to an annual revenue per acre of \$2,300 to the port.

As administrator of the state's tidelands, the State Lands Commission has discretionary authority to lease or not lease tidelands and to set lease rates it deems to be in the best interests of the state. Lease rates for marine terminal facilities, including wharves and mooring areas, are set by the State Lands Commission at approximately six percent of the appraised value of the land. The appraised value is determined by the Commission staff.

The determinations of appraised values are largely arbitrary. For example, as one appraisal report stated:

"The valuation of tide and submerged land presents an inherent difficulty in that the land is unique and there are very few sales of similar lands in California. Thus comparative sales data are rare, scattered, and too often require speculative adjustment to bring into comparative analysis form for valuation measurement with a Subject Property".

With few exceptions, tidelands are the exclusive property of the state and certain local jurisdictions acting as trustees for the state. Ordinarily, tidelands may not be sold. As a result, there is little comparable sales and market value data available. Due to a lack of such data, the very few actual sales are used repeatedly. In fact, the appraised values are set largely as a result of protracted negotiations between the Commission staff and company representatives.

In our judgment, the value of tidelands to a commercial user is relative to the amount of income estimated from its use, and lease rates based on the number of barrels of petroleum and related products transferred between ship and shore would be a far more equitable basis than arbitrary determinations of appraised values.

The Executive Officer of the Commission stated that lease revenues should consider the public's loss of use of the area. We concur, but believe, that these revenues should also reflect the significant value of the leases to the oil and public utility companies.

We estimate that in 1972, 240 million barrels of petroleum and related products were transferred between ship and shore in connection with the 27 tidelands leases. As previously noted, these leases are currently producing revenues of only \$198,545.72 annually.

Of the three major ports in California, the Port of Long Beach charges 3/4 cent per barrel for all petroleum and related products loaded or unloaded through private pipelines in the port. The Port of Los Angeles currently charges 1/2 cent per barrel but anticipates an increase to 3/4 cent. Oil tankers do not normally load or unload at the Port of San Francisco.

In our judgment, a rate based on the volume of products transferred between ship and shore would result in more equitable revenues to the state.

RECOMMENDATION

WE RECOMMEND THAT, IN RENEWALS AND FUTURE LEASES OF STATE-OWNED TIDELANDS FOR MARINE TERMINAL FACILITIES, THE STATE LANDS COMMISSION CHARGE A MINIMUM RATE OF ONE CENT PER BARREL FOR PETROLEUM AND RELATED PRODUCTS TRANSFERRED BETWEEN SHIP AND SHORE.

SAVINGS

We estimate that following implementation of this recommendation, annual revenues to the state from these leases will double within the first two years and will total a minimum of \$2.4 million annually, after all of the leases have been renewed.

As an alternative to the preceding recommendation, the imposition of a tax offers the potential of an immediate increase in state revenues from all of the existing leases and would have a minute affect on the profits of oil companies.

We recognize that constitutional problems may preclude limiting such a tax to just those marine terminal facilities located under State Lands Commission leases. In such event, the tax would have to be expanded to all California marine terminal facilities.

RECOMMENDATION

WE RECOMMEND THAT THE LEGISLATURE CONSIDER THE IMPOSITION OF A MINIMUM RATE OF ONE CENT PER BARREL TAX ON EACH BARREL OF PETROLEUM AND RELATED PRODUCTS UNLOADED IN CALIFORNIA PORTS AND TERMINALS.

SAVINGS

Based on 240 million barrels of oil annually, a minimum one cent per barrel tax would immediately produce revenues of at least \$2.4 million annually to the state. If the tax were expanded to all California marine terminal facilities, the annual state revenues would amount to \$3.5 million.

NO INTEREST CHARGED ON
RETROACTIVE LEASE PAYMENTS

The State Lands Commission has often entered into protracted negotiations with oil companies regarding lease rates. The Commission and a company first agree to a lease of tidelands for marine terminal facilities and then negotiate the rates for such leases while the parties are performing as though the lease were completely effected.

While retroactive payments are made after firm lease rates are established, the Commission does not charge the companies interest on such retroactive payments. These prolonged negotiations often take years to complete.

For example, during fiscal year 1972-73, 11 years after negotiations for one of the leases had begun, the Commission approved firm lease payments for five leases with Standard Oil Company of California for the use of tidelands to transfer petroleum and related products between ship and shore.

Standard paid \$429,319.64 in retroactive payments for these five leases. However, the Commission did not include any interest in the retroactive payments made by Standard, which allowed the lessee to use the state's money interest free for up to 11 years.

The schedule below summarizes the retroactive payments made by Standard Oil Company of California for these five leases.

Retroactive Lease Payments

<u>Lease Number</u>	<u>Payment</u>	<u>Period Covered By Retroactive Payment*</u>	<u>Date Of Payment</u>
2785	\$113,908.42	9/14/61 - 9/13/72	3/27/72
4497	70,579.44	8/27/70 - 8/26/73	1/04/73
437	29,603.66	10/6/69 - 10/5/71	1/31/73
236	171,145.50	8/19/67 - 8/18/73	3/13/73
139	<u>44,082.62</u>	3/4/62 - 3/3/74	3/12/73
	<u>\$429,319.64</u>		

* Amounts include some prepayments.

The state would have received an additional \$120,000 had the Commission imposed six percent interest, compounded annually, on the retroactive payments.

Two lease agreements have recently been negotiated by the Commission staff with Phillips Petroleum Company. The state will lose approximately \$110,000 if the Commission does not charge interest on the retroactive payments. These leases are scheduled to be presented to the Commission for its approval at its February 6, 1974 meeting.

RECOMMENDATION

WE RECOMMEND THAT THE STATE LANDS COMMISSION INCLUDE INTEREST AT NOT LESS THAN THE PRIME RATE ON RETROACTIVE LEASE PAYMENTS. IN THE EVENT OF THE FAILURE OF THE COMMISSION TO ADOPT THIS POLICY, WE RECOMMEND THAT THE LEGISLATURE CONSIDER ADOPTION OF LEGISLATION TO REQUIRE SUCH INTEREST.

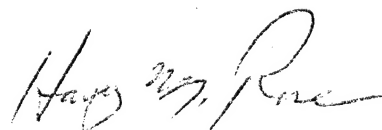
SAVINGS

Implementation of this recommendation will produce additional interest income to the state of approximately \$110,000 for the two Phillips leases. Additional savings could result from charging interest on subsequent retroactive payments.

COMMENTS OF THE EXECUTIVE OFFICER
OF THE STATE LANDS COMMISSION

1. The Auditor General and his staff are not appraisers and, therefore, not in a position to determine whether lease revenues are high or low.

2. The appraisal process is a judgmental or subjective type process and only arbitrary in the sense that judgment is used.
3. Appraisals of submerged lands are not a common practice. Comparable sales data are used in the appraisal process to the extent available, but such sales data are rare.
4. The lease revenues should not be based on the usefulness of the tidelands to lessees but rather based on the loss of the public's use of the area.
5. A lease rate based on the number of barrels of petroleum transferred between ship and shore would be difficult to administer and similar rates for commodities other than petroleum might then have to be established.
6. Due to the extensive improvements and services which Long Beach provides, the Port of Long Beach leases are not comparable to the state's leases which cover unimproved areas.



Harvey M. Rose
Auditor General

January 31, 1974

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